No. 12338

In the United States Court of Appeals for the Ninth Circuit

NORTHWESTERN MUTUAL FIRE ASSOCIATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The only previous opinion is that of the Tax Court promulgated March 30, 1949 (R. 48-66), which is reported in 12 T.C. 498.

JURISDICTION

The petition for review (R. 67-70) involves deficiencies in federal income taxes determined by the Commissioner against the taxpayer, Northwestern Mutual Fire Association, for the taxable years 1942 and 1943, in the amounts of $5,089.03 and $5,347.81, respectively. On July 18, 1947, the Commissioner mailed to the taxpayer a notice of deficiency in such taxes in the aggregate amount of $10,436.84. (R. 14-20.) Within 90 days

thereafter, and on October 14, 1947, the taxpayer filed a petition with the Tax Court of the United States for the redetermination of such deficiencies under Section 272 (a) (1) of the Internal Revenue Code. (R. 4-20.) The decision of the Tax Court that there are deficiencies in income taxes for the years 1942 and 1943 in the respective amounts of $5,089.03 and $5,347.81 was entered March 30, 1949. (R. 66.) The proceeding is brought to this Court by a petition for review filed June 24, 1949 (R. 67-71), under the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the taxpayer is entitled to a foreign tax credit, under Section 131 of the Internal Revenue Code, in each of the taxable years 1942 and 1943 on account of the Canadian "net premium" tax paid by it in each of those years.

The answer to this question depends upon whether the Canadian "net premium" tax is a tax paid "in lieu of a tax upon income * * * otherwise generally imposed by any foreign country," within the meaning of Section 131 (h) of the Code.

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes and other authorities involved are set out in the Appendix, *infra*.

STATEMENT

The findings of fact made by the Tax Court (R. 48-57) are based upon a stipulation of facts (R. 24-42), and may, for the purposes in hand, be summarized as follows:

The deficiencies determined by the Commissioner against the taxpayer, a domestic mutual fire insurance company, are due primarily to the disallowance by the

Commissioner of a foreign tax credit in each of the taxable years 1942 and 1943 on account of a Canadian "net premium" tax paid by the taxpayer in each of those years in the equivalent in terms of United States funds of the sums of $15,272.16 and $16,202.54, respectively, under the Special War Revenue Act of 1915, Revised Statutes of Canada of 1927, as amended by the Statutes of Canada of 1942, c. 32, Part III. (R. 48-50.)

The taxpayer's gross income for 1942 and 1943 from all sources was $6,716,320.72 and $7,045,067.97, respectively, and its gross income from sources in Canada, in terms of United States funds, was $507,681.54 and $533,-987.07, respectively. (R. 51.)

In 1942 and 1943, the taxpayer's "normal-tax net income" from all sources was $126,451.85 and $151,828.23, respectively, while for these years its normal-tax net income from sources in Canada, in terms of United States funds, was $37,843.46 and $40,943.06, respectively. (R. 52.)

During these years, the taxpayer was not liable on its net income from Canadian business under the provisions of the Canadian Income War Tax Act of 1917, as amended, the provisions of which are set forth in the Revised Statutes of Canada of 1927, c. 97. (R. 52-53.)

Prior to 1942, the taxpayer was required by the provisions of the Special War Revenue Act of 1915, Revised Statutes of Canada of 1927, c. 179, to pay to the Dominion of Canada a tax of one percent on its net premiums from its business within Canada. In 1942, an Act to Amend the Special War Revenue Act of 1915, Statutes of Canada of 1942, c. 32, increased the "net premium" tax on all fire insurance companies doing business in Canada, including the taxpayer. For all mutual fire insurance companies, such as the taxpayer, not subject to taxation on their net income under the Income War Tax Act of 1917, the rate was increased

from one to three percent. For all fire insurance companies which were subject to the Canadian tax on their net income under the Income War Tax Act of 1917, which did not include the taxpayer, the rate was increased from one to two percent. (R. 53-54.)

In 1946, mutual fire insurance companies, including the taxpayer, were made subject to the general income tax laws of Canada by an Act to Amend the Income War Tax Act of 1917, Statutes of Canada of 1946, c. 55. (R. 54.)

Concurrent with the above noted changes in the Income War Tax Act of 1917, the Special War Revenue Act of 1915, as amended in 1942, was amended further by an Act to Amend the Special War Revenue Act of 1915, Statutes of Canada of 1946, c. 65, Sec. 2, so as to reduce the rate of the tax from three to two percent. (R. 55.)

In 1942 and 1943, the taxes imposed by the Special War Revenue Act of 1915, as amended, as well as by the Income War Tax Act of 1917, as amended, were paid to the Minister of National Revenue, sometimes referred to as the Finance Minister. In these years, the administrative details of collection and auditing of taxes payable by insurance companies under the Special War Revenue Act of 1915, as amended, as well as the auditing of income tax returns of insurance companies which were subject to the provisions of the Income War Tax Act of 1917, as amended, were handled by the Department of Insurance. However, in those years, the details of collection and auditing of taxes other than taxes on insurance companies payable under the Special War Revenue Act were handled by the Department of National Revenue. (R. 56.)

In its returns for 1942 and 1943, the taxpayer used as a basis for computing its foreign tax credit under Section 131, the ratio of its gross income from Canada to

its total gross income in each of those years and thus computed its credit for 1942 in the amount of $5,076.60 and for 1943 in the amount of $5,339.84. However, in its claims for refund for those years, it computed its credit for each year on the basis of the ratio of its "normal-tax net income" from sources in Canada to its "normal-tax net income" from all sources.[1] (R. 56-57.)

The Tax Court held that the taxpayer was not entitled to the credit claimed by it in either year and accordingly sustained the Commissioner's deficiency determination. (R. 65-66.)

SUMMARY OF ARGUMENT

Whether the taxpayer is entitled to a foreign tax credit under Section 131 of the Internal Revenue Code in each of the taxable years 1942 and 1943 on account of the Canadian "net premium" tax paid by it in each of those years depends upon whether such tax is a tax paid "in lieu" of a tax on net income, within the meaning of subsection (h) of that section, which was added to the Code by Section 158 of the Revenue Act of 1942. We first discuss the facts in the light of the applicable federal and Canadian statutes under our subpoint A, and then, under our subpoint B, the question whether the Canadian "net premium" tax is one paid by the taxpayer "in lieu" of a tax on income, otherwise generally imposed by the Dominion of Canada, within the meaning of Section 131 (h).

A. The taxpayer, a mutual fire insurance company, had net investment income in 1942 and 1943 both from sources within the United States and from sources within Canada, which was subject to an income tax in

[1] It may here be noted that, under Section 207 (b)(4), the "normal-tax net income" of mutual insurance companies, including the taxpayer, was their investment income, which was subjected to the income tax by subsection (a)(1)(A) and (B) of that section.

the United States under Section 207 of the Code, as amended by Section 165 of the Revenue Act of 1942. In the taxable years here in question, mutual insurance companies were exempt from the Canadian income tax, but were subject to a so-called "net premium" tax in Canada. Section 207 (a)(1) of the Internal Revenue Code imposes an income tax at the rate of 30 percent upon the taxpayer's total net investment income. Alternatively, subsection (a)(2) of the section imposes a "special tax" of one percent upon the gross amount of its investment and "net premium" income, provided that such "special tax" is greater than the tax upon the net investment income. In the case at bar, the "special tax" was the greater in each year. Consequently, the amount thereof was assessed and paid in each year. The Canadian "net premium" tax is a business privilege or franchise tax, rather than an income tax, within the meaning of the term "income tax" used in Section 131 of the Code, which grants a credit on account of foreign taxes described therein and to the extent therein provided. While, in its income tax returns for 1942 and 1943, the taxpayer computed a foreign tax credit for each year on the gross amount of its net income for each year, as defined by Section 207 (b) (1), before the Tax Court it claimed, as it claims here and therefore concedes, that the basis to be used is the ratio of its "normal-tax net income," that is, its investment income, in Canada to its entire "normal-tax net income," as provided in Section 131 (b)(1). Since the taxpayer concedes that it is not entitled to the credit unless it is entitled thereto under Section 131 (h), the sole question here presented is whether the Canadian "net premium" tax is "a tax paid *in lieu of a tax upon net income* * * * otherwise generally imposed by any foreign country" within the meaning of that section. (Italics supplied.)

B. The critical words in Section 131 (h) are the words "in lieu of a tax upon income." It is well settled that, in the application of Section 131, the criteria of the federal and not the criteria of the foreign laws determine the meaning of the term "income taxes." It follows that, in determining what is a tax "in lieu of a tax upon income," the criteria of the federal and not of the Canadian laws are determinative. In any event, an inquiry into the Canadian purpose is illusory, and is, at best, merely an inquiry into a question of fact. Such inquiry is, therefore, obviously foreclosed by the Tax Court's finding against the taxpayer. The taxpayer's contention that Congress had the Canadian "net premium" tax specifically in mind when it enacted Section 131 (h) has nothing whatever to support it; so, also, the taxpayer's contention that Congress intended thereby to overrule the administrative and judicial decisions holding that it was not an income tax. Indeed, the contrary appears from the Senate Report, for this report states that Section 131 (h) was designed to give relief in cases where the foreign country which imposes income taxation, and which, because of administrative difficulties in determining either net income or taxable basis, authorizes an American company doing business therein to pay a tax, in lieu of an income tax, *measured* by gross income or gross sales, or number of units produced, or by some other method which is the equivalent of the income tax. But Canada had no such difficulty. It just did not impose an income tax upon the investment income of mutual insurance companies, or upon any other income of such companies in 1942 and 1943, though it did later in 1946. And it imposed no tax "in lieu" thereof, in the sense that it imposed no other tax in respect of a mutual insurance company's investment income or investment business, however measured. Moreover, the Senate Report cautions that the limita-

tion provisions of Section 131 remain applicable. Therefore, what we are looking for here is a Canadian tax upon investment income, measured in some other way than by an income tax upon the net amount thereof. The requirements of Section 131 (h) are satisfied only so long as there is a direct relationship between the Canadian exaction and the American tax base. Such, for example, would be a tax upon the taxpayer's gross investment income, as indicated, or upon its doing an investment business, or upon the holding of investments by it, measured by their value. Conceivably, there may be other ways of measuring such a tax; but, by definition, a tax upon "net premiums" is obviously not one of these.

ARGUMENT

The Taxpayer Is Not Entitled to a Foreign Tax Credit in Each of the Taxable Years 1942 and 1943 on Account of the Canadian "Net Premium" Tax Paid by It in Each of Those Years

In this case, it is exceedingly important that the facts be understood in the light of both the applicable federal and Canadian statutes. We have, therefore, divided our argument into two parts. Under our subpoint A we shall discuss the facts in their relation to these statutes, leaving to our subpoint B the argument upon the sole question here involved, namely, whether the Canadian "net premium" tax is one which was paid by the taxpayer "in lieu of a tax upon income," otherwise imposed by the Dominion of Canada, within the meaning of Section 131 (h) of the Internal Revenue Code, as added thereto by Section 158 (f) of the Revenue Act of 1942 (Appendix, *infra*).

A. *The facts in their relation to the provisions of both the federal and Canadian statutes*

The taxpayer is a domestic mutual fire insurance company which did a business as such in the taxable

years 1942 and 1943 both in the United States and in Canada. During these years, it had a total net investment income of $126,451.85 and $151,828.23, respectively, of which $37,843.46 was derived from sources in Canada in 1942 and $40,943.06 in 1943.

In these years, the taxpayer was exempt from the Canadian income tax upon its Canadian income, including its investment income by the Income War Tax Act of 1917, Revised Statutes of Canada of 1927, c. 97. (R. 53.) On the other hand, it was subject to a federal income tax imposed upon its entire investment income, derived both from sources in the United States and from sources in Canada, under Section 207 of the Internal Revenue Code, as amended by Section 165 of the Revenue Act of 1942 (Appendix, *infra*).

Subsection (b)(4) of Section 207 defines the "net income" of a mutual insurance company as its "gross investment income," less tax-free interest, investment expenses, real estate expenses, depreciation, interest paid or accrued, and capital losses. In passing, it may be noted that "net income," as thus defined, is referred to in subsection (a)(1)(A) and (B) of Section 207, which imposes the income tax thereon, as "normal-tax net income," and that this is likewise the designation given thereto in Section 131 (b)(1), as amended by Section 130 of the Revenue Act of 1943 (Appendix, *infra*), which, as hereinafter explained, contains the credit limitation provisions. For the definition of "normal-tax net income" see Section 13 (a)(1) and (2) (Appendix, *infra*). Subsection (b)(1) of Section 207 defines the "gross investment income" of such company to be the gross amount of income derived by it during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in Section 117.

By subsection (a)(1)(A) of Section 207, already referred to, a normal tax of 30 percent is imposed upon the company's "normal-tax net income" (subject to a qualification not here important), that is, upon its "net income" as defined by subsection (b)(4); and, by subsection (a)(1)(B), a surtax of 20 per cent is imposed upon its surtax net income, as defined by Section 15 (a) of the Code (Appendix, *infra*). However, alternatively, a "special tax" [2] of one percent, or, in circumstances not material here, of two percent, is imposed by subsection (a)(2) (if such special tax is greater than that imposed by subsection (a)(1)), upon the "gross amount of income," exceeding $75,000 during the taxable year, derived from interest, dividends, rents, and net premiums, minus dividends to policyholders, minus interest which is excluded from gross income under Section 22 (b)(4), and less the amount of the excess profits tax imposed under Subchapter E of Chapter 2 of the Code.

"Net premiums" are defined by subsection (b)(2) of Section 207 to mean gross premiums (including deposits and assessments) written or received on insurance contracts during the taxable year, less return premiums and premiums paid or incurred for reinsurance. And "dividends to policyholders" are defined by subsection (b)(3) to be dividends and similar distributions paid or declared to policyholders, the term "paid or declared" to be construed in accordance with the method regularly employed by the insurance company in keeping its books.

In the case at bar, the income tax upon the taxpayer's net investment income under subsection (a)(1) of Section 207, was $55,635.87, and the "special tax" upon the

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[2] So called in S. Rep. No. 1631, 77th Cong., 2d Sess., p. 151 (1942-2 Cum. Bull. 504, 615-616).

gross amount of its income under subsection (a)(2) was $67,150.78. Thus, since the tax computed upon the taxpayer's gross amount of income in the taxable year 1942 was larger by $11,514.91 than that computed upon its net investment income, its tax liability under Section 207 for that year was the larger amount. (Pet. Ex. 1-A.) And, since the income tax upon the taxpayer's net investment income under subsection (a)(1) of Section 207, as reported for the taxable year 1943, was $65,385.01, and upon the gross amount of its income under subsection (a)(2), $70,442.71, here too, the "special tax" computed on the taxpayer's gross amount of income was greater, by $5.057.70, than that computed upon its net investment income, and its tax liability under Section 207 for 1943 was in the larger amount. (Pet. Ex. 6-F.)

In 1942, the taxpayer's "net premiums," as defined by the Canadian War Revenue Act of 1915, as amended by an Act to Amend the Special War Revenue Act of 1915, Statutes of Canada of 1942, c. 32, Part III, to consist of gross premiums in Canada less rebates and return premiums and reinsurance premiums ceded to licensed companies (R. 50-51), amounted to $559,979.69 (Pet. Ex. 5-E), and in 1943 to $594,094.51 (Pet. Ex. 10-J). The "net premium" tax which the taxpayer paid to the Dominion of Canada in 1942 under that Act was $15,495.48, and in 1943, $17,822.81. This tax has been held to be a business privilege or franchise tax, rather than an income tax, within the meaning of the term "income tax" as used in Section 131 of the Code (Appendix, *infra*), which embodies the foreign tax credit provisions thereof. I.T. 3188, 1937-2 Cum. Bull. 230; *Continental Insurance Co.* v. *Commissioner,* 40 B.T.A. 540; *St. Paul Fire & Marine Ins. Co.* v. *Reynolds,* 44 F. Supp. 863 (Minn.); *Helvering* v. *Queen Ins. Co.,* 115 F. 2d 341 (C.A. 2d); cf. I.T. 3211, 1938-2 Cum. Bull.

177, involving similar "net premium" taxes of the Canadian provinces.

In its returns for each of the taxable years 1942 and 1943, the taxpayer claimed a credit under Section 131 of the Code on account of the amount of "net premium" tax it had paid the Dominion of Canada in each year. The amount of the credit claimed for 1942 was $5,076.60, and that for 1943 $5,339.84. Such amounts were computed under the limitation provisions of Section 131 (b)(1), already referred to. But the taxpayer computed the credit in its returns on the gross amount of income for each year, as defined by Section 207(a)(2). (R. 56-57.) However, before the Tax Court, the taxpayer claimed, as it claims here and thus concedes (Br. 80-81), that, in computing such credit under Section 131(b)(1), the ratio to be used is the taxpayer's "normal-tax net income" in Canada to its entire "normal-tax net income", upon which the income tax was imposed under Section 207(a)(1)(A) and (B), as stated. In other words, the taxpayer's foreign tax credit, if any, is concededly limited by Section 131(b)(1) to an amount represented by the ratio which its net investment income in Canada bears to its entire net investment income.

The taxpayer concedes that it is not entitled to the credit on account of the Canadian "net premium" tax which it paid unless it is entitled thereto in virtue of subsection (h) of Section 131, already referred to, because that tax is not an income tax. However, subsection (h) allows the credit for a tax paid "in lieu" of such a tax, and the taxpayer claims that the Canadian "net premium" tax qualifies as such under that subsection. Whether it does or not is, therefore, the sole question in this case and we shall address ourselves thereto.

B. *The Canadian "net premium" tax is not "a tax paid in lieu of a tax upon income * * * otherwise generally imposed by any foreign country," within the meaning of Section 131 (h) of the Code.*

Section 131 (h) provides as follows:

> (h) *Credit for Taxes in Lieu of Income, Etc., Taxes.*—For the purposes of this section and section 23 (c)(1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid *in lieu of a tax upon income,* war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States. (Italics supplied.)

The critical words, of course, are the words "in lieu of a tax upon income."

It is now well settled that, in the application of Section 131, the criteria presented by our own revenue laws and court decisions, and not by those of foreign laws, control the meaning of the term "income taxes," as used therein. *Biddle* v. *Commissioner,* 302 U. S. 573, 578, 579; *Keasby & Mattison Co.* v. *Rothensies,* 133 F. 2d 894, 897 (C.A. 3d), certiorari denied, 320 U. S. 739; *New York & H. Rosario Min. Co.* v. *Commissioner,* 168 F. 2d 745 (C.A. 2d); *H. H. Robertson Co.* v. *Commissioner,* 176 F. 2d 704 (C.A. 3d).

It follows that, since Section 131 (h) merely assimilates to a foreign tax paid on income, in respect of which the credit is allowed, a foreign tax paid "in lieu" thereof, what is such an "in lieu" tax depends upon our own, and not upon the foreign law. It is, therefore, wholly beside the point to argue, as the taxpayer does, that, under Canadian law, and particularly in the light of the legislative history of the amendments of the Canadian "net premium" tax and of the enactment of other more or less related tax measures, a conclusion is

admissible that Canada intended to impose or to retain such tax "in lieu" of an income tax upon the taxpayer's net investment income.

In any event, an inquiry into the purpose of the Canadian Parliament to impose, or to retain, a "net premium" tax in lieu of an income tax upon the taxpayer's net investment income is not only illusory, but is preeminently an inquiry into a question of fact, and the Tax Court, upon a view of all the facts, has already answered that question against the taxpayer's contention. Therefore, whether the "net premium" tax is one which Canada intended to impose or retain as a substitute for an income tax upon the taxpayer's net investment income, if relevant, is, we submit, a question which is not open to review here, for the evidence is by no means so conclusive as to justify a conclusion that it was. To the contrary, the answer to that question depends wholly upon the weighing of conflicting inferences which may be drawn from the evidence; and certainly, the fact that in 1946 Canada imposed a tax upon the net income of mutual insurance companies while retaining the "net premium" tax is ample evidence that Canada neither imposed nor retained the "net premium" tax as a substitute for the income tax.

Nor is the taxpayer's argument (Br. 38) persuasive that, in enacting the provisions of Section 131 (h), Congress expressly intended to permit a credit on account of this particular Canadian tax, on the theory that it satisfied the requirement of a tax imposed in lieu of the federal income tax and that, to this end (Br. 29-31), Congress intended legislatively to overrule not only the administrative rulings holding that such tax was not an income tax within the meaning of the federal law, but the decisions of both the Tax Court and the federal courts, as well, and particularly the decision of the United States District Court for the District of Minne-

sota in the case of *St. Paul Fire & Marine Ins. Co.* v. *Reynolds,* 44 F. Supp. 863.

The best that can be said is that, generally speaking, Congress had the whole field of foreign taxation in mind and knew that gains, profits and income, from whatever source derived, were at times, due to administrative difficulties in determining either net income or taxable basis, subjected to taxes in foreign countries which differed from the conventional federal income tax. Congress recognized that, nonetheless, such taxes involved the imposition of a double tax on the taxpayer's income when it was also subjected to the federal income tax. But he would be venturesome, indeed, who essayed to cull from the multitude of existing Bureau of Internal Revenue rulings, both published and unpublished, or from the multitude of cases decided by it without special rulings, those against which the amendment was specifically directed. What is made clearly to appear, however, from the Senate Report already referred to, namely, S. Rep. No. 1631, p. 131 (1942-2 Cum. Bull. 504, 602), is that Section 131 (h) was designed to give relief where, as stated, the foreign country which imposed "income taxation"—i.e., an income tax on income which was also subject to the federal tax—because of the administrative difficulties of determining net income or taxable basis, authorized an American domestic corporation doing business in that country to pay, as a substitute for the income tax otherwise imposed, a tax *measured* by gross income, gross sales, number of units produced, or by some other method which was the equivalent of the "income tax" otherwise imposed by such country. Of course, the evidence here does not disclose that Canada originally imposed, or that it later retained, the "net premium" tax because of any administrative difficulty in determining either the gross or net investment income of a

mutual insurance company, to be used as a base for the tax. Canada just did not impose a tax upon the net investment income of such companies, or upon their gross investment income, or any other kind of tax, in respect of their investment income or business.

In this connection, it is to be noted that the Senate Report referred to cautions that the limitation upon the amount of the credit will, of course, continue to apply, so that the credit is granted only to the extent that the taxpayer has net income from sources within the foreign country.

Thus in order to carry out the Congressional intent, what we must look for is a Canadian tax based upon investment income, however measured. In other words, the requirements of Section 131 (h) are satisfied only if the exaction has a direct relationship to the American tax base, such, for example, as a tax upon gross investment income, or a tax upon the doing of an investment business, or a tax upon the holding of investments measured by their value. For, while any of these taxes would not satisfy the technical criteria of the federal income tax, it would obviously satisfy the criteria of a tax levied "in lieu" thereof; and, at the same time, it would, of course, also satisfy the criteria of the tax base used in the limitation provisions of subsection (b)(1) of Section 131.

Moreover, it is only by so construing Section 131 (h) that a true relationship is established between the federal and the foreign tax and the object of the statute attained. Thus, and thus only, is subsection (h) brought into harmony with both subsections (a) and (b) of Section 131. On the other hand, diametrically the opposite is true if Section 131 (h) is construed as the taxpayer contends it should be. As stated, if the Canadian tax on net premiums is allowed as a credit, it can admittedly be allowed only to the extent that

the taxpayer has taxable gross investment income from Canadian sources which could be reduced to net investment income by applying federal tax provisions, the credit being limited, of course, as provided in Section 131 (b) (1). Thus, if, for example, the taxpayer had no investment income in Canada, it would obviously not be entitled to any credit on account of the Canadian "net premium" tax. Only if the Canadian "net premium" tax were substituted as the numerator and the gross amount of income determined under Section 207 (a)(2) were substituted as the denominator in the ratio provided for in the limitation provisions of Section 131 (b)(1) (which the taxpayer, however, no longer claims to be proper), would it be possible to bring the allowance of a credit on account of the Canadian "net premium" tax, as an "in lieu" tax within the meaning of Section 131 (h), into harmony with the limitation provisions of Section 131 (b)(1). Indeed, the very fact that such substitution is not permissible under Section 131 (b)(1) is the basis of the Commissioner's additional reason for disallowing the credit, which is that "a proper application of the provisions of Section 131 of the Internal Revenue Code negatives the use of investment income as the basis for computing the limitation factor provided for under subsection (b) thereof, in the case of a mutual insurance company (other than life or marine) paying a tax based upon 'the gross amount of income' as defined in Section 207 of the Internal Revenue Code." (R. 17.)

The taxpayer's contention (Br. 18-20) that Section 29.131-2 of Treasury Regulations 111 (Appendix, *infra*), inadvertently referred to by the taxpayer as Treasury Regulations 103, supports a contrary view is wholly without merit. It will be noted that these Regulations stress the fact referred to in S. Rep. No. 1631, *supra,* that the reason for the amendment lay in

the administrative difficulties a foreign country might have in determining net income, when it would, however, have no difficulty in determining gross income. Consequently, the Regulations say, also following the language of the Senate Report, that the tax might be laid, for example, on gross income and thus qualify for a credit under Section 131 (a). But we look in vain to the Regulations to justify the grant of the credit on account of a foreign excise tax levied on mutual insurance companies in respect of "net premiums" derived from its insurance business in the foreign country.

And this also disposes of the taxpayer's contention (Br. 35-36) that, because, in this case, the amount of the tax was alternatively computed on the gross amount of the income, including the total of "net premiums," a double tax was imposed upon Canadian "net premiums," which Congress sought to obviate by Section 131 (h). The specific answer to this contention, of course, is that the alternative "special tax" was designed merely to produce a larger tax in certain cases than that produced by the tax upon taxable net income as defined by Section 207 (b)(4). In the case at bar, this is the taxpayer's net investment income, which does not, of course, include "net premium" income. The result is that only the excess of the tax on the taxpayer's gross amount of income, imposed under Section 207 (a)(2), over the tax on its net investment income, imposed under Section 207 (a)(1), is properly attributable to the imposition of the "special tax."

But such excess, together with the method of taxation by which it was arrived at, was deliberately disregarded by Congress in fixing the basis for the credit and its limitation under Section 131 (b). Obviously, if Congress had intended that a credit for the Canadian "net premium" tax should be allowed against the "special tax," because the Canadian "net premiums" were

included in the "special tax" base, it could, and unquestionably would, have specifically so provided in Section 131 (h). In this connection it may be noted that Section 207 (a)(2), imposing the special tax, was enacted in the Revenue Act of 1942, as was Section 131 (h). Thus, had the House amendment of Section 207 been enacted into law, instead of the Senate's substitution therefor, it might with force have been argued that, if subsection (h) had in that situation been added, the Canadian "net premium" tax was a tax paid "in lieu" of the income tax imposed upon mutual insurance companies. And the taxpayer might well have referred in support thereof to the quotation from the House Report (H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 27-28 (1942-2 Cum. Bull. 372, 395)) which it makes without apparent application in its Appendix No. VII (Br. p. marked "Appendix 8"). See also the same report, pp. 113-118 (1942-2 Cum. Bull. 372, 456-460). Under the House amendment,[3] mutual insurance companies were taxed on their entire net income, including "net premiums," which were similarly defined as in the Canadian act.

Instead, Congress adopted the Senate amendments of Section 207, which, as stated, imposed an income tax upon the net investment income of mutual insurance companies, and only alternatively the "special tax" on the amount of gross income, if that was larger. At the same time, however, by its 1942 amendment of Section 131 (a)(1), the foreign tax credit was not expanded by subsection (h) to include a tax on "net premium" income, but only to include a tax imposed "in lieu" of net income tax, i.e., in this case, in lieu of an income tax on "net investment" income, such as

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[3] For the convenience of the Court, the provisions of the House bill as it was reported to and as it passed the House, which are identical, are set out in full at the end of the Appendix, *infra*.

a tax upon gross investment income, or, perchance, a tax laid in respect of the doing of an investment business, measured by the value of the investments.

Thus, under Section 131 (a)(1), as amended by Section 158 (a) of the Revenue Act of 1942, a credit was allowed in respect of any income, war profits, or excess profits taxes paid by a corporation to any foreign country, and by Section 131 (b)(1), as first amended by Section 158 (d) of the 1942 Act, the credit was limited by the ratio which the corporation's net income from sources within such country bore to the sum of its "normal-tax net income" and the amount of the credit for adjusted excess profits tax income provided in Section 26 (e) of the Code, for the same year. Moreover, when by Section 130 (b)(1) of the Revenue Act of 1943 Congress again amended Section 131 (b)(1) retroactively to years beginning after December 31, 1939, it provided that the corporation's credit should be limited by the same proportion of the tax against which the credit is taken, which its "normal-tax net income" from sources within the foreign country bears to its entire "normal-tax net income" for the same taxable year. The Senate Report, S. Rep. No. 627, 78th Cong., 1st Sess., pp. 62-64 (1944 Cum. Bull. 973, 1019-1020), elaborately explains that the reason for this amendment was properly to reflect foreign dividends in the credit of certain corporations.

Thus, nowhere is there the slightest indication that Congress intended by Section 131 (h) to permit the inclusion in the credit base of anything but "normal-tax net income," or to allow the credit to be taken on account of a foreign tax which was not levied in respect of such base.

It seems to us, therefore, that what we have said demonstrates that Congress did not intend Section 131 (h) to apply to the Canadian "net premium" tax.

The foregoing analysis also shows, we think, that the taxpayer's reliance upon authorities which hold taxing statutes, and particularly the remedial provisions thereof, should be liberally construed in the taxpayer's favor, is wholly misplaced. We are here to determine what the construction of Section 131(h) should fairly be; that is to say, to fairly delimit the relief thereby granted. This is not at all impossible, as we have seen, without the resort to a rule of thumb, such as that which the taxpayer seeks to apply, and which, in any event, would be available, if at all, as an aid in construction only when all other rules of construction fail. As Mr. Justice Stone said in *White* v. *United States,* 305 U. S. 281, 292—

> We are not impressed by the argument that, as the question here decided is doubtful, all doubts should be resolved in favor of the taxpayer. It is the function and duty of courts to resolve doubts. We know of no reason why that function should be abdicated in a tax case more than in any other where the rights of suitors turn on the construction of a statute and it is our duty to decide what that construction fairly should be. Here doubts which may arise upon a cursory examination of §§ 101 and 115 disappear when they are read, as they must be, with every other material part of the statute, *Hellmich* v. *Hellman, supra,* 237, and in the light of their legislative history. Moreover, every deduction from gross income is allowed as a matter of legislative grace, and "only as there is clear provision therefor can any particular deduction be allowed . . . a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms." *New Colonial Ice Co.* v. *Helvering,* 292 U. S. 435, 440.

Similarly, we are here dealing with a credit against the tax, which is allowed only as a matter of legislative grace, and the provisions granting credits, like

those granting exemptions and deductions, are strictly to be construed, so that it is incumbent upon the taxpayer seeking the credit to show that he clearly comes within the provisions of the statute allowing it. See *Helvering* v. *Northwest Steel Mills,* 311 U. S. 46, 47; *United States* v. *Stewart,* 311 U. S. 60, 71; *Deputy* v. *du Pont,* 308 U. S. 488, 495; *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440.

CONCLUSION

For the reasons stated, the decision of the Tax Court should be affirmed.

Respectfully submitted,

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JANUARY, 1950.

APPENDIX

Internal Revenue Code:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) [as amended by Sec. 201 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 105 of the Revenue Act of 1942] *Definitions.*—For the purposes of this chapter—

(1) *Adjusted net income.*—The term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(2) *Normal-tax net income.*—The term "normal-tax net income" means the adjusted net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b).

* * * * *

(26 U.S.C. 1946 ed., Sec. 13)

SEC. 15 [as amended by Sec. 104 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 105 (b) of the Revenue Act of 1942]. SURTAX ON CORPORATIONS.

(a) *Corporation surtax net income.*—For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26 (b) (computed limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26 (h). For the purposes of this subsection

dividends received on the preferred stock of a public utility shall be disregarded in computing the credit for dividends received provided in section 26 (b).

* * * * *

(26 U.S.C. 1946 ed., Sec. 15.)

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) [as amended by Section 158 (a) of the Revenue Act of 1942]. *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102 or section 450, shall be credited with:

(1) *Citizens and Domestic Corporations.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * *

(b) [as amended by Section 130 (a) of the Revenue Act of 1943]. *Limit on Credit.*—The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed, in the case of a taxpayer other than a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year, or in the case of a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's normal-tax net income from sources within such country bears to its entire normal-tax net income for the same taxable year; * * *

* * * * *

(h) [as added by Section 158 (f) of the Revenue Act of 1942]. *Credit for Taxes in Lieu of Income, Etc., Taxes.*—For the purposes of this section and section 23 (c) (1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States.

(26 U.S.C. 1946 ed., Sec. 131.)

SEC. 207 [as amended by Section 165 (b) of the Revenue Act of 1942]. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE.

(a) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the income of every mutual insurance company (other than a life or a marine insurance company and other than an interinsurer or reciprocal underwriter) a tax computed under paragraph (1) or paragraph (2) whichever is the greater and upon the income of every mutual insurance company (other than a life or a marine insurance company) which is an interinsurer or reciprocal underwriter, a tax computed under paragraph (3):

(1) If the corporation surtax net income is over $3,000 a tax computed as follows:

(A) *Normal Tax.*—A normal tax on the normal-tax net income, computed at the rates provided in section 13 or section 14 (b), or 30 per centum of the amount by which the normal-tax net income exceeds $3,000, whichever is the lesser; plus

(B) *Surtax.*—A surtax on the corporation surtax net income, computed at the rates provided in section 15 (b), or 20 per centum of the amount by which the corporation surtax net income exceeds $3,000, whichever is the lesser.

(2) If for the taxable year the gross amount of income from interest, dividends, rents, and

net premiums, minus dividends to policy holders, minus the interest which under section 22 (b) (4) is excluded from gross income, exceeds $75,000, a tax equal to the excess of—

(A) 1 per centum of the amounts so computed, or 2 per centum of the excess of the amount so computed over $75,000, whichever is the lesser, over

(B) the amount of the tax imposed under Subchapter E of Chapter 2.

(3) In the case of an interinsurer or reciprocal underwriter, if the corporation surtax net income is over $50,000 a tax computed as follows:

(A) *Normal Tax.*—A normal tax on the normal-tax net income, computed at the rates provided in section 13 or section 14 (b), or 48 per centum of the amount by which the normal-tax net income exceeds $50,000, whichever is the lesser; plus

(B) *Surtax.*—A surtax on the corporation surtax net income, computed at the rates provided in section 15 (b), or 32 per centum of the amount by which the corporation surtax net income exceeds $50,000, whichever is the lesser.

(4) *Gross Amount Received Over $75,000 But Less than $125,000.*—If the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) is over $75,000 but less than $125,000, the amount ascertained under paragraph (1), paragraph (2) (A), and paragraph (3) shall be an amount which bears the same proportion to the amount ascertained under such paragraph, computed without reference to this paragraph, as the excess over $75,000 of such gross amount received bears to $50,000.

(5) *Foreign Mutual Insurance Companies Other Than Life or Marine.*—In the case of a for-

eign mutual insurance company (other than a life or marine insurance company), the net income shall be the net income from sources within the United States and the gross amount of income from interest, dividends, rents, and net premiums shall be the amount of such income from sources within the United States.

(6) *No United States Insurance Business.*—Foreign mutual insurance companies (other than a life or marine insurance company) not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.

(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Investment Income.*—"Gross investment income" means the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in section 117;

(2) *Net Premiums.*—"Net premiums" means gross premiums (including deposits and assets) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (3);

(3) *Dividends To Policyholders.*—"Dividends to policyholders" means dividends and similar distributions paid or declared to policyholders. The term "paid or declared" shall be construed according to the method regularly employed in keeping the books of the insurance company;

(4) *Net Income.*—The term "net income" means the gross investment income less—

(A) *Tax-free Interest.*—The amount of interest which under section 22 (b) (4) is excluded for the taxable year from gross income;

(B) *Investment Expenses.*—Investment expenses paid or accrued during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this subparagraph shall not exceed one-fourth of 1 per centum of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which net income computed without any deduction for investment expenses allowed by this subparagraph, or for tax-free interest allowed by subsection (b) (4) (A), exceeds 3¾ per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(C) *Real Estate Expenses.* — Taxes and other expenses paid or accrued during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid or accrued by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

(D) *Depreciation.*—A reasonable allowance, as provided in section 23 (1), for the exhaus-

tion, wear and tear of property, including a reasonable allowance for obsolescence;

(E) *Interest Paid or Accrued.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this chapter.

(F) *Capital Losses.*—Capital losses to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of interest, dividends, rents, and net premiums received. In the application of section 117 (e) for the purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(i) the corporation surtax net income (computed without regard to gains or losses from sales or exchanges of capital assets); or

(ii) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(c) *Rental Value of Real Estate.*—The deduction under subsection (b) (4) (C) or (b) (4) (D) of this section on account of any real estate owned and occupied in whole or in part by a mutual insurance company other than life or marine, shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

(d) *Amortization of Premium and Accrual of Discount.*—The gross amount of income during the taxable year from interest, the deduction provided in subsection (b)(4)(A), and the credit allowed against net income in section 26 (a) shall each be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company other than life or marine. Such amortization and accrual shall be determined (1) in accordance with the method regularly employed by such company, if such method is reasonable, and (2) in all other cases, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

(e) *Deduction of Foreign Corporations.*—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

(f) *Double Deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

(g) *Credits Under Section 26.*—For the purposes of this section, in computing normal tax net income and corporation surtax net income, the credits provided in section 26 shall be allowed in the manner and to the extent provided in sections 13 (a) and 15 (a).

(26 U. S. C. 1946 ed., Sec. 207.)

Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 101. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

Except as otherwise expressly provided, the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1941.

SEC. 158. FOREIGN TAX CREDIT.

* * * * *

(d) *Limit on Credit in Case of Corporations.*—Section 131 (b) is amended to read as follows:

"(b) *Limit on Credit.*—The amount of the credit taken under this section shall be subject to each of the following limitations:

"(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income, in the case of a taxpayer other than a corporation, or to the sum of the normal-tax net income and the amount of the credit for adjusted excess profits net income provided in section 26 (e), in the case of a corporation, for the same taxable year;

* * * * *

Revenue Act of 1943, c. 63, 58 Stat. 21:

SEC. 130. TECHNICAL AMENDMENTS RELATING TO FOREIGN TAX CREDIT.

* * * * *

(c) *Taxable Years to Which Applicable.*—The amendment made by subsection (a) shall be effective for all taxable years beginning after December 31, 1941. The amendment made by subsection (b) shall be effective with respect to all taxable years beginning after December 31, 1939.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.131-2. MEANING OF TERMS.—The term "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. For the purposes of section 131 and section 23 (c) (1) the term "income, war-profits, and excess-profits taxes" includes a tax imposed by statute or decree by a foreign country or by a possession of the United States if (a) such country or possession has in force a general income tax law, (b) the taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax, and (c) such general income tax is not imposed upon the taxpayer thus subject to such substituted tax. For example, the A Corporation does business in the X country, which imposes an income tax upon substantially a net income base. The ascertainment of net income, though not the determination of gross income, from sources in X country is found administratively difficult. The X country, by decree, provides that corporations circumstanced as was the A Corporation would, in lieu of the income tax at the rate of 20 per cent otherwise payable, be subject to tax at

the rate of 10 per cent upon the amount of gross income from X country. In accordance with such decree, the A Corporation paid X country the sum of $25,000 in 1943 with respect to its tax liability to the X country for the year 1942. Such amount, subject to the applicable limitations, is available as a credit to the A Corporation as foreign income, war-profits, or excess-profits taxes against the United States tax liability for the year 1942. * * *

H. R. 7378, 77th Cong., 2d Sess. [Revenue Bill of 1942 as reported and as passed House]:

SEC. 147. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

* * * * *

(b) *Taxable Companies.*—Section 207 (relating to taxation of mutual insurance companies other than life) is amended to read as follows:

"SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

"(a) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every mutual insurance company (other than a life insurance company) the corporation surtax net income of which is over $50,000, a tax computed as follows :

"(1) *Normal Tax.*—A normal tax on the normal-tax net income, computed at the rates provided in section 13, or 48 per centum of the amount by which the normal-tax net income exceeds $50,000, whichever is the lesser; plus

"(2) *Surtax.*—A surtax on the corporation surtax net income, computed at the rates proprovided in section 15 (b), or 42 per centum of the amount by which the corporation surtax net income exceeds $50,000, whichever is lesser.

"(3) *Ledger Assets Over $100,000 But Less Than $150,000.*—If the mean of the ledger assets

held at the beginning and end of the taxable year is over $100,000 but less than $150,000, the tax under this subsection shall be an amount which bears the same proportion to the sum of the lesser amounts ascertained under paragraphs (1) and (2) as the excess over $100,000 of such mean of the ledger assets bears to $50,000.

"(4) *Normal-tax and Corporation Surtax Net Income of Foreign Mutual Insurance Companies Other Than Life.*—In the case of a foreign mutual insurance company (other than a life insurance company), the normal-tax net income shall be the net income from sources within the United States minus the credit provided in section 26 (a), the credit provided in section 26 (b), and the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (c), and the corporation surtax net income shall be the net income from sources within the United States minus the credit provided in section 26 (b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e).

"(5) *No United States Insurance Business.*—Foreign mutual insurance companies (other than a life insurance company) not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.

"(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

"(1) *Gross Income.*—'Gross income' means the sum of (A) investment income as defined in paragraph (2), (B) underwriting income as de-

fined in paragraph (4), and (C) all other items constituting gross income under section 22;

"(2) *Investment Income.*—'Investment income' means the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in section 117, less (A) losses from sales or exchanges of capital assets to the extent provided in section 117, (B) investment expenses, (C) real estate expenses, (D) depreciation, and (E) interest paid;

"(3) *Investment Expenses, Etc.*—As used in this section the terms 'investment expenses', 'real estate expenses', 'depreciation', and 'interest paid' shall have the same meaning, and shall be subject to the same limitations, as in section 201 (c) (7) (B), (C) and (D), section 201 (c) (6) (A), and section 201 (d) (relating to life insurance companies), but shall be computed as if the word 'paid' wherever it appears therein were 'paid or accrued';

"(4) *Underwriting Income.*—'Underwriting income' means net premiums received during the taxable year on insurance contracts plus any decrease during such year in any of the items specified in subparagraph (C) less:

"(A) Losses paid in excess of salvage and reinsurance recoverable;

"(B) Underwriting expenses and loss adjustment expenses paid or accrued;

"(C) The increase during the taxable year in any of the following items: (i) unearned premiums; (ii) unpaid losses; and (iii) surplus apportioned to policyholders;

"(D) Dividends and similar distributions paid to policyholders out of premium income and surplus apportioned to policyholders. Dividends and similar distributions paid to policyholders shall be considered to be paid out of

premium income and surplus apportioned to policyholders only to the extent they exceed the sum of the investment income of the taxable year available to pay dividends and similar distributions in that year plus the investment income of the preceding taxable years (if beginning after December 31, 1941) available to pay such dividends and similar distributions in such years but not so used;

"(5) *Net Premiums Received.*—'Net premiums received during the taxable year on insurance contracts' means gross premiums (including premium deposits and assessments) written or received on insurance contracts less return premiums and premiums paid for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (4) (D);

"(6) *Surplus Apportioned to Policyholders.*—

"(A) *In General.*—'Surplus apportioned to policyholders' means such portion of the surplus of the company as is held for distribution to policyholders before the expiration of five years after the termination of their policies in equitable proportion to the amount of the surplus contributed by each policyholder or group of policyholders and includes amounts set aside for the payment of dividends and similar distributions to policyholders. The amount of surplus apportioned to policyholders shall in no case be considered to exceed an amount which would leave unapportioned surplus equal to or less than the unapportioned surplus as of the beginning of the first taxable year which begins after December 31, 1941;

"(B) *Limitation on Amount Includible.*—For the purposes of subparagraph (A), no

amount shall be included in surplus apportioned to policyholders unless, under the provisions of the insurance contract, or by the by-laws of the company, the distribution of such amount is specifically required and the distribution is not at the discretion of the directors of the company. The fact that the distribution of an amount can be withheld in order to comply with requirements of State law, or may be subjected to lien or assessment to meet abnormal loss or decline in market value of assets, shall not prevent the inclusion of such amount in surplus apportioned to policyholders. In no case shall an amount held for more than five years from the termination of the policy be included in surplus apportioned to policyholders;

"(C) *Special Rule for Taxable Years Beginning After December 31, 1941, and Before January 1, 1945.*—For the purposes of subparagraph (A), for taxable years beginning after December 31, 1941, and before January 1, 1945, an amount shall be included in surplus apportioned to policyholders if includible under subparagraph (B) or if payable to policyholders under the established normal practice of the company;

"(7) *Investment Income Available To Pay Dividends And Similar Distributions.*—'Investment income available to pay dividends and similar distributions' means investment income for the taxable year (computed without regard to section 117 (d) and (e) less (A) an amount equal to 21 per centum of the interest on obligations with respect to which a credit is allowable under section 26 (a) (relating to interest on certain obligations of the United States), and (B) an amount equal to 45 per centum of so much of the investment income (computed with regard to section 117 (d) and (e)) as exceeds the sum of (i) the interest on obligations with respect to

which a credit is allowable under section 26 (a), plus (ii) the interest on obligations described in section 22 (b) (4), plus (iii) the credit provided in section 26 (b) (relating to dividends received on stock of domestic corporations);

"(8) *Net Income.*—'Net income' means the gross income as defined in paragraph (1) of this subsection less the following deductions:

"(A) All deductions as provided in section 23 to the extent not otherwise allowed;

"(B) The amount of the net operating loss deduction provided in section 23 (s) except that in computing such deduction the terms 'third preceding taxable year', 'second preceding taxable year', and 'first preceding taxable year' as used in section 122 shall not include any taxable year beginning before January 1, 1942; and

"(C) The amount of interest which under section 22 (b) (4) is excluded for the taxable year from gross income.

"(c) *Deductions of Foreign Corporations.*—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

"(d) *Double Deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted."

(c) *Cross Reference.*—For stamp tax on policies written by foreign insurers, see section 502 of this Act.

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